Furniss v Dawson, adieu

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PETE MILLER discusses the recent Special Commissioners decision in EDI Services and Others.

IN EDI SERVICES and Others(No 2)[2006] STC (SCD) 392, the Special Commissioners, Stephen Oliver and Howard Nowlan, reviewed the current state of the Ramsay doctrine, comparing the pre- and post-Westmoreland/BMBF approaches. They found for HMRC on both bases, but made it clear that the purposive approach is preferred to the old-style method of 'disregarding' intermediate steps inserted solely to avoid tax and with no commercial purpose. See 'Golden NI', (Update, Taxation, 6 July 2006, page 373) for a short report of the decision.

**Background**

EDI was one of many companies that paid directors' bonuses in the form of gold coins, and was taken as a test case on the point; the Special Commissioners' powers to designate a lead case was the subject of EDI Services (No 1). Bonuses had been paid in gold coins in 1994 and 1995 and the broad issue was whether the coins were to be disregarded as earnings for the purposes of employers' National Insurance as being 'payments in kind', so that no employers' contributions were due from EDI.

At all material times, the coins were kept in a bank vault in Switzerland (outside the EU so no VAT arose on the transaction) by the owner. The coins were bought for EDI by a dealer, GIL, and transferred to the directors. The directors were invited to keep the coins, which would carry a storage and insurance fee, accept delivery of the coins, which would carry a VAT and delivery charge, or sell through a dealer for a fee. At no time was the Swiss bank ever aware of any change of ownership of the coins it was holding.

There was no reference in the letters to directors to selling through GIL. However, the directors knew that so doing, on terms that were especially favourable in comparison to any other dealer, was the only real option, and the Commissioners discounted evidence that the directors had explored the option of selling through other dealers. They also discounted evidence that one of the directors seriously considered keeping the coins as a long-term investment.

In practice, all coins received by the directors in this way were immediately sold back to GIL,
not just by the directors of EDI but, according to the evidence, in every one of the cases under review for which EDI was the test case.

The company said …

EDI referred to *NMB Holdings v Secretary of State for Social Security* 73 TC 85, a similar case involving payment of bonuses with platinum sponge, where the sponge was transferred to the directors and immediately sold back to the trader from which the employer had originally acquired it. The Special Commissioners applied the classical Ramsay approach, so the platinum sponge was ignored, as being there only for tax avoidance and with no commercial purpose, and the bonuses were treated as payments of cash, liable to employers' National Insurance.

Lord Hoffmann approved this decision in *MacNiven v Westmoreland Investments Ltd* [2001] STC 237, saying that, 'In commercial terms the directors were paid in money'. So he applied the commercial/legal dichotomy that he developed in the *Westmoreland* judgment and applied it to give the same result as given by the classical Ramsay approach.

EDI contended that this proved that the Special Commissioners in *NMB* had reached the right decision but for the wrong reasons, in the light of the modern Ramsay doctrine following *Westmoreland* and, more importantly, *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1. Applying the new, purposive approach, EDI said that *NMB* was correctly decided by looking at what was intended by Parliament. In *NMB*, there were clearly arrangements for the directors to sell the platinum sponge immediately for cash and no real alternative to doing so.

In contrast, EDI said that it had not had arrangements permitting immediate sale by the directors, thus the gold coins could not be considered to be tantamount to cash, on a purposive approach. The company noted that gold is more readily retained as an investment and said that it had also enquired into this and into alternative disposal routes, albeit that the Commissioners did not accept that evidence.

Another purposive approach to the legislation would suggest that contributions were not intended to apply to payments in kind because the rules only allowed employees' contributions to be taken by deduction from salary. But the Commissioners said that, even though it was possible for a person's cash salary to be too small to permit full deduction of the employee's contributions, an employer could retain a small amount of gold to sell, in order to fund the National Insurance. So the legislation did not inherently imply that any payment in a form other than cash had to be a payment in kind.

Finally, the company argued that the focus of the legislation was on the employer, which had paid bonuses in gold coin, and that the fact that directors then sold the coins was mere 'happenstance', not to be considered as part of the purposive approach.

In relation to the 1995 transfers, where the legislation excluded from payments in kind assets in respect of which there were 'trading arrangements', the company argued that this meant arrangements whereby the directors could realise the same amount as the expense incurred by the company. Since the gold coins were sold for an open market price, there were no such arrangements. The Commissioners gave this argument short shrift, saying there were clearly trading arrangements.

**HMRC's arguments**
HMRC's first argument was that the legislation should be construed as if 'payment in kind' refers only to the situation where the subject matter of the payment is intended to be enjoyed as such by the recipient. Therefore, a purposive approach would suggest that the legislation cannot apply where the recipient would inevitably sell the asset and enjoy the proceeds instead.

Alternatively, a classical Ramsay approach would suggest that the arrangements were a single composite whole and there was no practical likelihood of the steps not completing as envisaged in a short time. Therefore, the inserted steps, which had no commercial purpose and were merely there to avoid tax, should be disregarded and the bonuses should be treated for tax purposes as if they had been paid in cash.

Finally, HMRC argued that there were trading arrangements in respect of the 1995 bonuses. The facts showed that GIL was expecting to reacquire the coins on every occasion and with the minimum of delay. These arrangements were there to permit the directors to realise the bonuses and the amounts paid were never, in fact, significantly different from the expenses incurred by the employer in providing them in the first place.

**Decision**

On the purposive analysis, the Special Commissioners found that the arrangements constituted a 'mechanism designed to deliver cash'. This followed from the finding of fact that there was never an intention that anyone would keep the gold coins and that it was always envisaged that the coins would be immediately sold back to GIL.

They then held that a 'mechanism designed to deliver cash' was not a 'payment in kind' on a purposive interpretation. Taken together, the finding was that the earnings 'were gold, designed to be converted into money'. In contrast, the classical Ramsay approach would treat the payments as having been made in cash, as in NMB.

Overall, the finding was that the mechanism of the bonuses, designed to deliver cash, was not what was intended by the legislation in exempting payments in kind from liability to employers' National Insurance. Furthermore, the Special Commissioners made it clear that they found the post-BMBF purposive approach to Ramsay 'more natural' than the classical approach.

Looking at the classical approach, they observed that, if Furniss v Dawson [1984] STC 153 is still good law, they must be able to analyse that case in the new way. They said that Furniss required a much greater degree of re-analysis than did EDI to get to the result actually given by the court. Since the House of Lords has consistently held that Furniss remains good law, the Commissioners found that the classical approach could also be applied to EDI, to elide the composite transaction into a simple payment of a cash bonus.

But they stated that this is inconsistent with the approach taken by the House of Lords in Westmoreland or BMBF. For example, while BMBF might be seen as merely a scheme to confer the capital allowances on a UK taxpayer, the House of Lords had held that the facts could not be re-analysed and it had only to decide whether BMBF had acquired an asset that qualified for capital allowances. Therefore, the Commissioners said:

> 'on the current approach to analysing the facts, we cannot collapse and ignore the intermediate steps, and treat the [EDI] as having paid cash.'

As noted, the Commissioners also found there were trading arrangements in place in respect of 1995 onwards, although having found for HMRC on the Ramsay analysis, this did not make
any difference.

Comment

On first glance, this judgment appears to be a comprehensive rebuttal of the old-style Ramsay approach. A more detailed review confirms this view. Contrast, for example, the statement that whether Furniss is still good law 'has not overtly been judicially questioned' with 'we ... find this approach to be quite inconsistent with [Westmoreland and BMBF] and to be altogether inconsistent with the actual decision in [BMBF].'

In one sense, Ramsay has come full circle: in EDI, the Special Commissioners are saying that a mechanism to deliver cash is not what was intended as a payment in kind by the legislation. In Ramsay, Lord Wilberforce famously said that the loss was not the sort of loss the legislation was meant to relieve. Indeed, in the 1936 US case of Helvering v Gregory, Judge Learned Hand took the same approach, saying that Congress had not intended to relieve reorganisations of the kind the taxpayer had carried out. So after 26 years, we are back to the original formulation — is this what was intended by Parliament?

The Special Commissioners compared the two approaches, which may have practical implications. First, the near inevitability of the steps enabled them to find for HMRC under the new, purposive approach, as a mechanism to deliver cash, as well as under the traditional approach, i.e. by ignoring the inserted steps and finding the reality to be a payment of cash.

In contrast, if a single person retained the gold coins, the purposive approach could still apply to treat the arrangements as a mechanism to deliver cash from the employer's perspective. But this would be fatal to the traditional approach, since the steps cannot be inevitable if they are not actually carried out (hence the distinction between Furniss and Craven v White [1988] STC 476, involving identical arrangements, but where the result was not inevitable in the latter case).

It follows that the new approach needs only to take into account the intention of the person to whom the relevant statutory provisions apply. Here, the legislation applies to the employer and not the employee; in BMBF it applied to the claimant of the capital allowances, not to the user of the plant. The traditional approach may require an analysis of the intentions of all the parties.

Practical implications

The purposive approach is judicial authority to look at the precise words of the legislation, if it is closely articulated, as much recent legislation is. Furthermore, most new legislation has an internal anti-avoidance rule, usually referring in some way to 'the' or 'a' main purpose of avoiding tax. If transactions are undertaken for commercial reasons, so that the specific anti-avoidance rule cannot apply, it is hard to see how HMRC can counter any planning on the basis of a strict purposive approach.

Where legislation is less closely articulated, the approach seems to give the courts scope to apply the intention, or assumed intention, of Parliament, particularly where there is no commercial basis for the transactions. So it is also important when looking at older, less closely articulated legislation, to ensure a real commercial basis for the transactions, and to document that thoroughly, so as to be able to prove it to HMRC or the Commissioners, if necessary. These days, it is standard practice for HMRC to ask for all documents relating to any tax planning, including internal memos and e-mails. In part, they are looking for evidence that the transactions are tax-driven, so that they can invoke motive-based anti-avoidance
rules, or proof that there is no commercial reason for them, so that the courts can apply the purposive approach.

Conclusions

Any lingering vestiges of the classical Ramsay approach will quickly be eliminated if this decision is indicative of the approach the Special Commissioners are now taking, especially if the courts follow suit. For now, we must wait and see, but it appears that Lord Brightman’s famous formulation of the Ramsay doctrine may be consigned to the archives.

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